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8 March 1974

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[Redacted]

MEMORANDUM FOR: [Redacted] NIO
USSR and Eastern Europe

THROUGH : Director of Economic Research

SUBJECT : Support for Dr. Kissinger's Trip
to Moscow

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[Redacted]

Attached are an original and two copies of
U/RE's contribution covering the Soviet response to
the international oil crisis. If you have any questions
concerning the contribution, please call [Redacted]

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Attachment:
As stated

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OER/U/RE, [Redacted]

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Soviet Response to the International Oil Crisis

I. Effect on Soviet Oil Supply and Trade

1. In recent months Soviet petroleum officials and economists have expressed concern about problems the world energy crisis has caused them. They claim that the USSR does not have enough oil to meet simultaneously its own requirements, fill the needs of other socialist countries, and continue to expand deliveries to established markets in capitalist countries. The Soviet Union is experiencing some tightening of oil supply because of drilling and production problems. Crude oil output was below plan in 1972 and 1973, but the threat of shortages similar to those facing the US is not imminent. The USSR is a net exporter of about 2 million barrels per day (b/d) of oil, almost one-fourth of total indigenous production, and Moscow is reluctant to cut back on sales to the West because they provide much-needed hard currency. Nevertheless, Moscow has little, if any, uncommitted oil.

2. The USSR has both suffered and profited from the international oil crisis. The suffering arises from Soviet commitments to supply a major share of Eastern Europe's oil supplies through 1975 at fixed prices -- about \$2.50 per barrel -- approximately one-fourth of the current market

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price. Such deliveries at bargain rates now seem unattractive in comparison with opportunities for more profitable sales elsewhere. However, Moscow is unlikely to reduce its commitments to Eastern Europe to permit larger sales to the West. Economic disadvantage is offset by strong political motivation.

3. The Soviet Union also has been stung sharply by higher prices the Arab countries are charging for oil procured from them. Although the quantities are relatively small (300,000-400,000 bpd) most of this oil is delivered on Soviet account to other Communist countries -- primarily to Eastern Europe, which relies on such deliveries for 15-20% of total oil imports. During 1973 the Soviets obtained oil from Arab countries at relatively low prices under barter aid and trade arrangements. However, [redacted]

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[redacted] Iraq and Libya halted deliveries of crude oil to the USSR because Moscow refused to pay higher prices --

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4. On the profit side of the ledger, Soviet hard currency earnings should rise sharply in 1974 because of the higher prices Moscow will get for its oil from Western importers, even if the quantity sold remains at or near the 1973 level. [REDACTED] 25X1

[REDACTED] the USSR may not increase the quantity of exports but that prices will be considerably higher than in 1973. [REDACTED] 25X1

5. During 1973 the Soviets generally fulfilled their contractual obligations for delivery of oil to the West with no increase in price, albeit with some temporary interruptions and diversions. Perhaps because of the slower reaction time of the Soviet system, Moscow did not generally take advantage of higher prices for oil during the latter part of 1973. [REDACTED] 25X1

a higher spot price. However, Soviet oil deliveries to the US in 1973 rose to about 30,000 bpd, nearly 3 1/2 times the 8,600 b/d delivered in 1972. Most of this oil came on tankers returning to the US after delivering grain to the USSR. The average delivered price of this oil in 1973 was \$6.95 per barrel compared with only \$2.70 per barrel in 1972. But much of the increase in price can be attributed to a shift in the composition of the deliveries in favor of more expensive distillates.

II. Effect on Eastern Europe

6. Eastern Europe is feeling the pinch of Arab oil restrictions, although the effect may be less severe than in Western Europe since the bulk of Eastern Europe's oil imports come from the USSR. To overcome shortages, conservation measures have been introduced, and attempts are being made to import more oil from the Middle East and the USSR.

7. Yugoslavia and Poland were hit by cutbacks in shipments of oil products from West European suppliers, while Bulgaria has been hurt by smaller than expected deliveries of Iraqi oil on Soviet account. East Germany, Hungary, and Czechoslovakia are seeking new sources of oil in the Middle East and North Africa as Soviet shipments are not adequate to meet rising demands. Most of the East European countries are faced with paying much higher prices -- some \$13 to \$18 per

barrel -- for the Arab oil they need.

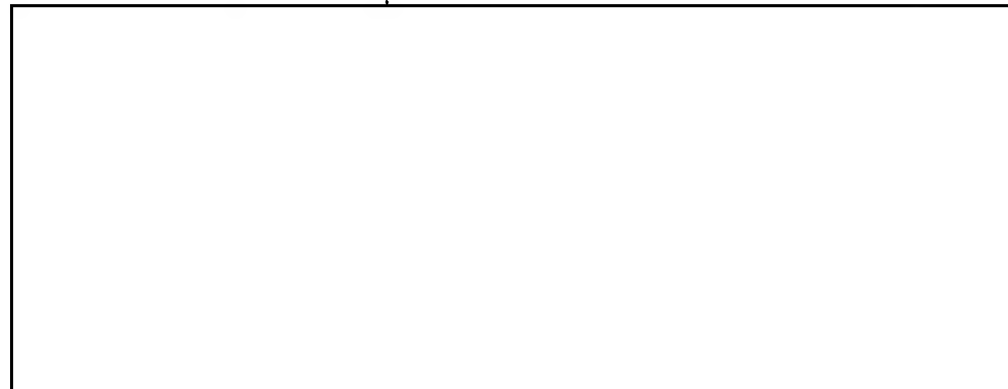
8. Romania, the only net exporter of oil in Eastern Europe, has imported crude oil from the Middle East for processing and re-export to the West for hard currency. Half of Romania's oil imports in 1973 (40,000 bpd) were to come from Iran via the Israeli pipeline, but this pipeline was closed during the Arab-Israeli conflict and Iranian deliveries declined sharply. To continue its profitable export trade, Bucharest has adopted an extensive oil rationing program and plans to divert as much oil as possible to foreign markets.

9. The oil shortage and higher import prices will put a further strain on Eastern Europe's hard currency balances. Transportation facilities also will be squeezed by the need to switch, where possible, to solid fuels. Moscow has indicated that it would not raise oil prices to Eastern Europe through 1975. But the issue is now under discussion for the 1976-80 plan period, and at least two countries -- Poland and Hungary -- already seem resigned to a substantial increase in Soviet prices. To pay higher prices for Soviet oil, East European countries will have to export more to the USSR or invest in development of Soviet fuels and raw materials. Eastern Europe probably will also try to moderate its balance of payments problems by using more

coal. It would be reluctant to accept slower rates of growth in industrial production.

10. Because of its hard currency situation Eastern Europe is scrambling to obtain Arab oil on a barter basis.

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III. Soviet Encouragement of Arab Use of Oil Weapon

11. Moscow undoubtedly sees substantial benefits to itself in the Arab oil embargo. It welcomes the weakening of Western economies and the split that has developed between the United States and its European and Japanese allies over the issue. Soviet propaganda broadcasts have in fact long encouraged the Arabs to employ oil as a weapon in their struggle against Israel. These broadcasts urged the curtailment of oil production, nationalization, and reduced sales as appropriate tactics. Nevertheless, Moscow has had little or no control over the Arab decision to restrict the flow of oil to the West, and there is no good evidence

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that the Soviets had any hand in planning or implementing the cutbacks in oil production.

12. There are some misgivings, moreover, among Soviet officials that the oil weapon could harm detente with the US. Because of the possibility of adverse Western reaction, Soviet media have not gloated over the Western predicament. The embargo, if successful, could also be turned against the USSR in the future.

13. Moscow, while cautious about predicting future developments in the oil crisis, advocates nationalization of oil companies instead of embargo. But the USSR does not want to support this position too strongly if detente with the West is at stake.

IV. Soviet Policy Concerning Consumer-Producer Arrangements

14. In January 1974 Moscow showed interest in participating in international negotiations on oil problems with both producer and consumer countries. The Soviets are concerned that any grouping of oil consumers or producers in which they do not participate will be able to affect the prices it pays and receives for oil and could have some impact on its plans to acquire Western oil technology.

15. Moscow might seek to use its participation in international oil negotiations to enhance its position with the Arabs. Soviet objections have been voiced against US

attempts to protect its oil companies from actions taken by oil producing countries. They also claim that the US is trying to annul existing bilateral oil agreements and to prevent future agreements between consumers and producers. Moscow decries US attempts to lay the blame for the oil crisis on the Arabs when the "real cause lies in the monopolistic policies of US-owned oil companies."

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